



Love Field Gate Recommendations

Assessment of optimal use of American's divested Love Field gates for the City of Dallas

April 22, 2014

The materials contained in this document are intended to supplement a discussion between the City of Dallas and L.E.K. Consulting on April 22, 2014. These perspectives are confidential and will only be meaningful to those in attendance.

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Agenda

- Background and objectives
- Review of airline proposals and recommendations
- Appendix

Dallas Love Field (DAL) is located in the City of Dallas and is currently restricted to 20 gates

Description	Aerial view	Neighboring airports												
Dallas Love Field (DAL) is a city-owned public airport 6 miles northwest of downtown Dallas, Texas. It was Dallas' main airport until 1974 when Dallas/Fort Worth International Airport opened														
Key Operational Statistics	Route network													
<ul style="list-style-type: none">Number of aircraft gates: 20*Annual passengers*: 8.1M (2013)Non-stop destinations: 44**Active passenger airlines: 4	<p>The ten busiest domestic routes out of DAL from Oct 2012- Oct 2013^^:</p> <table><tr><td>1. Houston, TX</td><td>6. New Orleans, LA</td></tr><tr><td>2. San Antonio, TX</td><td>7. Albuquerque, NM</td></tr><tr><td>3. Austin, TX</td><td>8. Lubbock, TX</td></tr><tr><td>4. Kansas City, MO</td><td>9. El Paso, TX</td></tr><tr><td>5. St. Louis, MO</td><td>10. Midland, TX</td></tr></table>	1. Houston, TX	6. New Orleans, LA	2. San Antonio, TX	7. Albuquerque, NM	3. Austin, TX	8. Lubbock, TX	4. Kansas City, MO	9. El Paso, TX	5. St. Louis, MO	10. Midland, TX	<ul style="list-style-type: none">Dallas Fort Worth (DFW), the primary international airport in the D/FW Metroplex and the largest hub for American Airlines		
1. Houston, TX	6. New Orleans, LA													
2. San Antonio, TX	7. Albuquerque, NM													
3. Austin, TX	8. Lubbock, TX													
4. Kansas City, MO	9. El Paso, TX													
5. St. Louis, MO	10. Midland, TX													
Airline market share^^	Strategic context													
<table><tr><td>1.</td><td></td><td>Southwest:</td><td>96%</td></tr><tr><td>2.</td><td></td><td>United:</td><td>2%</td></tr><tr><td>3.</td><td></td><td>Delta^:</td><td>2%</td></tr></table>	1.		Southwest:	96%	2.		United:	2%	3.		Delta^:	2%	<ul style="list-style-type: none">Due to the Wright Amendment Reform Act of 2006, in October of 2014, direct flights are no longer limited to the 9 nearby statesSouthwest Airlines' corporate headquarters is at Love Field, and Dallas is a focus city for themAs a result of the American-USAirways merger, AA must divest its 2 gates at DALThe close proximity to downtown Dallas and limited gate availability have generated significant interest in the 2 American gates	
1.		Southwest:	96%											
2.		United:	2%											
3.		Delta^:	2%											

Note: * Given the Wright Amendment Reform Act of 2006, Love field's capacity is limited to 20 gates; ^ Following the merger of American and US Airways, the U.S. DOJ is requiring American's 2 gates (currently sub-leased to Delta) to be divested at DAL **Nonstop flights with more than 50 passengers per day ^^Based on pax

Source: L.E.K. analysis of ARN Fact book, City of Dallas, Diio Mi; Bing Maps

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With the expiration of the Wright Amendment, 14 of the top 20 destinations from the Dallas/Fort Worth Metroplex will be served by DAL

Top 20 destinations from the D/FW Metroplex – both DAL and DFW (Q3 2012 – Q3 2013)

Rank	Destination*	Daily pax (incl. connect)	DAL service
1	LAX	2,124	Planned
2	NYC	1,965	Planned
3	CHI	1,652	Planned
4	WAS	1,499	Planned
5	SFO	1,300	No Service
6	DEN	1,261	Planned
7	ATL	1,234	Planned
8	LAS	1,208	Planned
9	HOU	1,066	Currently Served
10	MCO	910	Planned

Rank	Destination*	Daily pax (incl. connect)	DAL service
11	BOS	843	No Service
12	SAT	765	Currently Served
13	PHX	692	Planned
14	PHL	687	No Service
15	SEA	682	No Service
16	MSY	638	Currently Served
17	SAN	616	Planned
18	MSP	590	No Service
19	DTW	565	No Service
20	MCI	557	Currently Served

	Currently served by DAL
	Planned service from DAL
	No service from DAL

Note: * NYC (LGA, JFK, EWR, HPN), LAX (LAX, BUR, SNA, ONT, LGB), CHI (ORD, MDW), WAS (DCA, IAD, BWI) SFO (SFO, SJC, OAK) **Nonstop flight offered to destination from DAL or DFW ^Average of 75% to 85% load factor ^^Some flights may be operated by an E75 with the same number of seats ***Based on the assumption that Delta only gets two gates

Source: L.E.K. analysis of Diio Mi

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In its settlement with American, the DOJ is requiring AA to divest its two preferential use gates at Dallas Love Field (DAL)

- American Airlines will have to relinquish the gates at all airports under “commercial terms and conditions identical to those pursuant to which the gates and facilities are leased to New American”
 - There is no restriction on whether American can receive compensation for sub-leasing the gates
 - The DOJ’s intent with the divestiture is to create competition for American out of Dallas by leveraging the more convenient location of DAL to give an advantage to a new entrant
 - The DOJ claims rights to approve the selected carrier; their focus is on increased competition and facilitating new opportunities for low cost carriers
- “... The goal of the divestiture remedy is to enhance the ability of the LCCs to frustrate coordination among the legacy carriers ...”

The U.S. Department of Justice

- The DOJ prefers the gates be assigned to an LCC versus remain open for common use, to ensure that a new entrant has the right number and time for slots to compete effectively
 - The final agreement prohibits the merged company from reacquiring an ownership interest in the divested slots or gates
- “... Section XII of the proposed Final Judgment prohibits the merged company from reacquiring an ownership interest in the divested slots or gates during the term of the Final Judgment ...”

The U.S. Department of Justice

The City of Dallas is looking for a recommendation on the optimal use of American's two gates at DAL

- The close proximity of DAL to downtown Dallas and limited gate availability has generated significant interest in these gates from other airlines, including:



– Southwest (based in Dallas and currently the largest operation at DAL)



– Delta (currently sub-leases the two AA gates)



– Virgin America (potential new entrant at DAL)

- Given the critical role that DAL airport plays in the local economy and the important service they provide for the citizens of Dallas, the City is looking to develop a framework for evaluating potential new airline tenants for the gates
- The City of Dallas is seeking to establish a clear position on what the optimal outcome is for the City and its residents

The intent of this project is to identify the best new use of the AA gates at DAL for the City of Dallas, its citizens, and DAL itself

Primary Objective

- The primary objective of this project is to provide a framework for the City to evaluate the best use of American Airlines' divested gates at DAL and a well-reasoned position on the optimal outcome of the current process for the City of Dallas

Key Issues

- What overall objectives should guide the City's assessment of potential new airline tenants for the DAL gates?
- Who are the key stakeholders in the decision to award American Airlines' divested gates at DAL?
- What are the primary interests of each stakeholder group as they relate to the awarding of the DAL gates?
- What is an appropriate framework for evaluating the options and determining the optimal solution for the City?
- What specific criteria should be used to determine the "best" use of the gates for the City of Dallas? How should those criteria be weighted?
- How does each candidate airline rate across the key evaluation criteria?
- Overall, which airline (or airlines) represent the best fit for the DAL gates given the City's objectives and why?

The City of Dallas selected L.E.K. Consulting to conduct this work based on L.E.K.'s reputation and experience as a leading aviation strategy advisor

L.E.K. Aviation Credentials

- More than 25 years successfully advising on strategic issues in the aviation sector globally, with a combination of airline and airport advisory experience that is unique among consultants in the industry
- Leading strategic advisor to the global airline industry, where clients include more than half of the top 50 airlines around the world by market capitalization, including both major network carriers and leading LCCs
 - 2 of the 3 largest airline mergers in industry history
 - 2 of the 3 largest frequent flier programs in the industry
 - Chief architect of the merchandizing (ancillary revenue) movement in the U.S. industry and internationally
- Extensive work with leading airports and airport groups around the globe
 - Buy- and sell-side advisory work for airport privatizations
 - Commercial air service development strategies
 - Traffic forecasting
 - Retail master plan development

To complete this assessment, L.E.K. conducted extensive secondary research, leveraged internal expertise, and conducted independent analysis

L.E.K. did do

- Worked with DAL and the city of Dallas to understand their primary objectives, views of key stakeholders, and other relevant criteria
- Reviewed relevant proposals and materials prepared by airlines seeking to win the DAL gates
- Identified and outlined the key stakeholders
- Leveraged L.E.K. experience with airport development to outline high level objectives for each stakeholder
- Developed an evaluation framework and determined the relative importance of each scoring criterion
- Identified several potential gate-award scenarios
- Conducted secondary research and independent analysis to determine the attractiveness of each potential gate-award scenario
- Recommended a best case scenario for the City based on L.E.K.'s view of the relative importance of each objective

L.E.K. did not do

- Perform an in-depth, industry wide analysis on each potential airline that may or may not be interested in the DAL gates
- Conduct an interview campaign for each primary and secondary stakeholder to reinforce our independent assumptions
- Perform forecasting analysis to determine future passenger traffic for each gate and potential airline, including any QSI analysis
- Perform a route-level fare analysis to evaluate each potential possibility created with different entrants and scenarios
- Discuss this issue with any carrier, including those submitting a proposal
- Receive input from City officials on their desired outcome

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Delta (DL), Virgin America (VX), and Southwest (WN), have expressed interest in American's (AA) two gates at DAL



Proposed routes (flights/day)	<ul style="list-style-type: none"> ● ATL (6) ● LGA (5) ● MSP (3) ● DTW (3) ● LAX (5) 	<ul style="list-style-type: none"> ● LAX (4) ● SFO (4) ● LGA (4) ● DCA (4) ● ORD (2) 	<ul style="list-style-type: none"> ● CLT ● PHL ● DTW ● MSP ● EWR 	<ul style="list-style-type: none"> ● SFO ● SJC ● OAK ● SMF ● SEA ● PDX 	<ul style="list-style-type: none"> ● BOS ● RDU ● MEM ● IND ● ECP ● CHS
Proposed aircraft	<ul style="list-style-type: none"> ● CRJ-900 (76 seats) ● Boeing 717 (110 seats) 	<ul style="list-style-type: none"> ● A320 (146 seats) 	<ul style="list-style-type: none"> ● 737-700 (143 seats) ● 737-800 (175 seats) 		
Additional considerations	<ul style="list-style-type: none"> ● Requesting gates for common use, which Delta would then use as needed ● Requires 3 gates for its full plan, implying potential access to United's gates 	<ul style="list-style-type: none"> ● Dallas area expansion plans contingent upon obtaining 2 DAL gates ● Virgin has stated that they would exit DFW 	<ul style="list-style-type: none"> ● Southwest already has 16 of 20 gates at DAL ● Southwest cannot fly out of DFW without relinquishing DAL gates, so this is their most realistic expansion opportunity 		
Proposal thesis	<ul style="list-style-type: none"> ● Provide DAL with 1-stop access to global destinations 	<ul style="list-style-type: none"> ● Offer a competing network of flights with a differentiated product and lower fares to large business markets from DAL 	<ul style="list-style-type: none"> ● Introduce meaningful competition to American Airlines and more destinations from DAL 		

Given the City's responsibilities, Dallas residents and the local business community should be seen as the primary stakeholders in the gate decision

Stakeholders

Primary needs and motivations:

Primary stakeholders

Dallas residents

Local business community

- Greatest number of non-stop destinations from Dallas (DAL + DFW)
- Low fares
- Greatest number of non-stop destinations from Dallas (DAL + DFW)
- Best possible flight schedule / frequency of service
- New convenient premium class service at DAL
- Increased business activity

Secondary stakeholders

DAL airport

DAL airport employees

DFW airport

- Maximum traffic through the airport, increasing airport revenues
- Minimum risk of airline service level changes
- Maximum job creation
- Minimum direct route overlap between DFW and DAL, to reduce potential passenger loss

Other stakeholders not included in this analysis

DOJ

American Airlines

- Increased competition for AA in Dallas
- Greater LCC presence in Dallas and nationally
- Minimize number of competitors in the Dallas area
- Minimize direct route overlap

We have excluded "other stakeholder" considerations from our analysis in order to remain objective; The DOJ's needs do not necessarily overlap with the needs of the primary stakeholders

The City's main objective should be to maximize O&D passenger throughput across both DAL and DFW, as that would represent maximum utility for stakeholders

Objectives

Tier 1 objectives	1	Increase non-stop destinations from DAL
	2	Maximize O&D passenger throughput across DAL & DFW
Tier 2 objectives	3	Lower fares from DAL
	4	Minimize route overlap with DFW
	5	Add convenient premium class service at DAL
Tier 3 objectives	6	Increase number of DAL jobs
	7	Airline stability and commitment at DAL
	8	Add a partner that will contribute to the community

Needs met

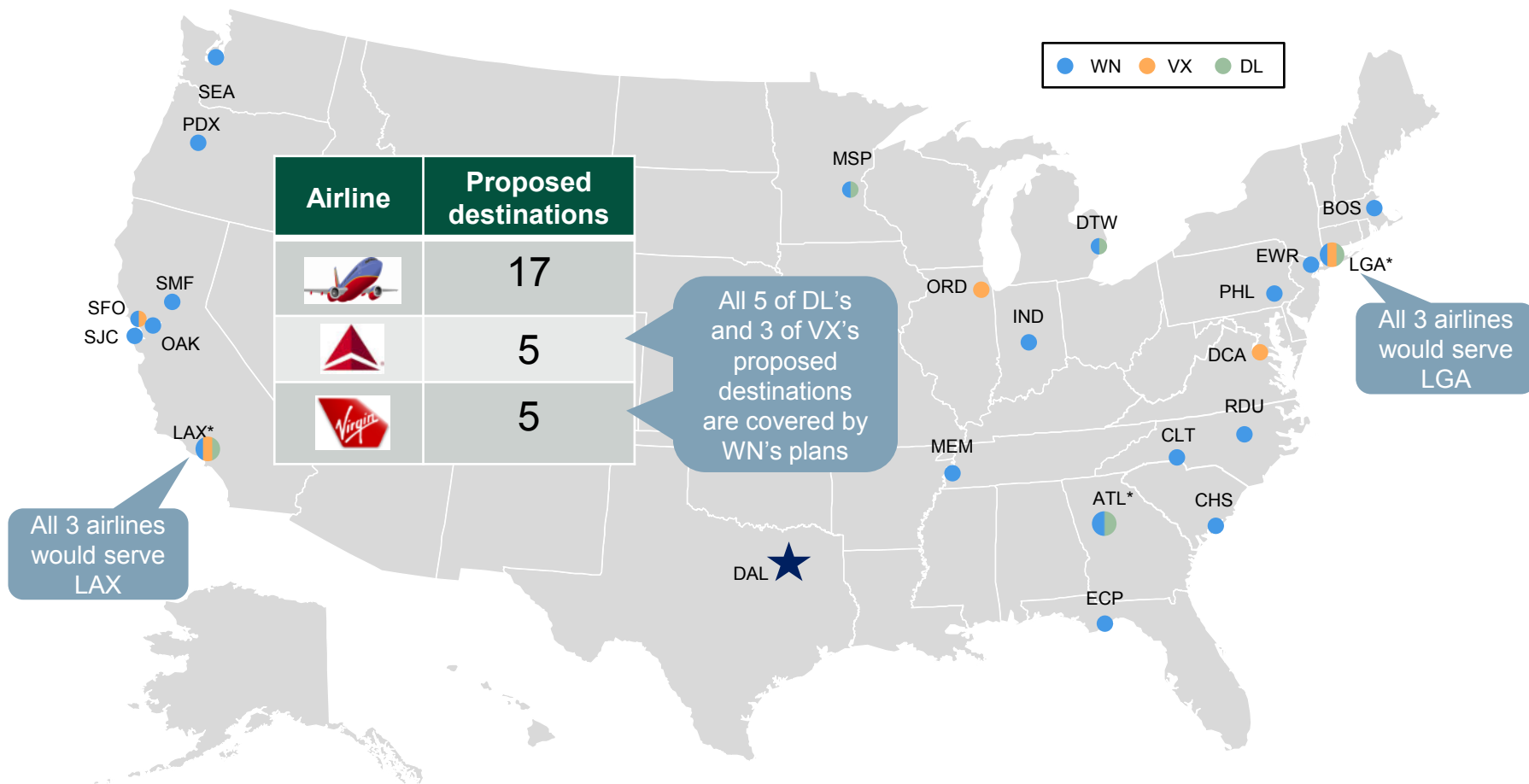
- More non-stop destinations from DAL
- Greatest number of key routes being served (demonstrated by demand)
- Maximize DAL aero & non-aero revenue
- Maximize local economic growth
- Maximize indirect jobs in Dallas
- Lower fares caused either by an increase in competition or new LCC entrant
- Limited cannibalization of existing DFW passenger volume
- New premium (first class) service to key cities from the more convenient DAL location (vs. DFW)
- Increase DAL jobs
- Minimize risk to DAL and City of Dallas given reliance on limited airlines; ensure longstanding commitment
- Commitment to the community

Stakeholders supported

- Residents
- Business community
- Residents
- Business community
- DAL airport
- DAL airport employees
- Residents
- Business community
- DFW Airport
- AA
- Business community
- Residents
- DAL airport
- DAL airport employees
- Residents
- Business community

1 Southwest's proposal would likely lead to the highest number of non-stop destinations from DAL

Proposed DAL destination airports for WN, VX and DL



Note: * Current/planned WN destinations w/out gates ^Includes destinations from Delta's and Virgin's proposals that Southwest is already planning to fly with its existing gates

Source: L.E.K. analysis of company proposals and Dio Mii

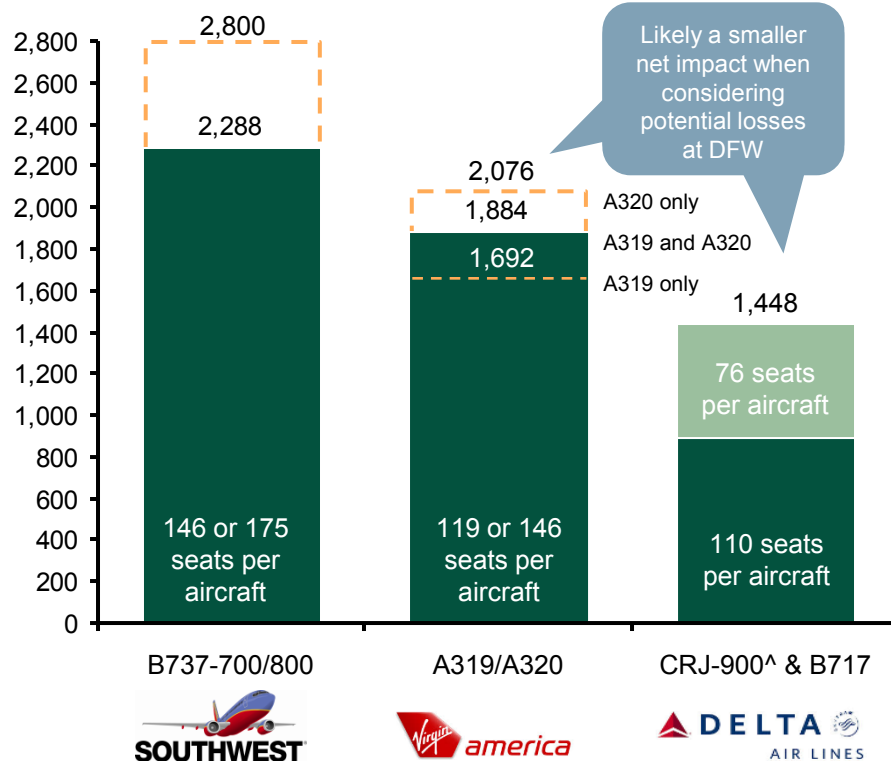
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2 Based on fleet plans and potential cannibalization at DFW, Southwest would likely drive the most passenger traffic across both DAL & DFW

Potential DAL passengers per day by aircraft type

Number of passengers*



Commentary

- Based on intended aircraft and gate usage, Southwest is projected to have the highest passenger throughput for DAL
 - While Southwest claims 737-800s would be deployed, 737-700s are more probable on marginal routes
- Virgin could serve nearly as many DAL pax as Southwest, but at some risk to DFW
 - While Virgin proposes using A320s; we have assumed they would split their service between A319s and A320s as a new entrant
 - As Virgin will be pulling out of DFW, the net impact to the Metroplex could only be 1,200 – 1,300 pax/day
- With smaller aircraft planned, Delta is expected to serve fewer passengers than WN or VX
 - Delta proposes using 16 CRJ-900s; while they suggest a 3rd gate would be necessary, we have capped their total flights at 20, matching Southwest
 - As these services would overlap with existing DFW service, it is likely that a substantial number of pax would be pulled from the existing service

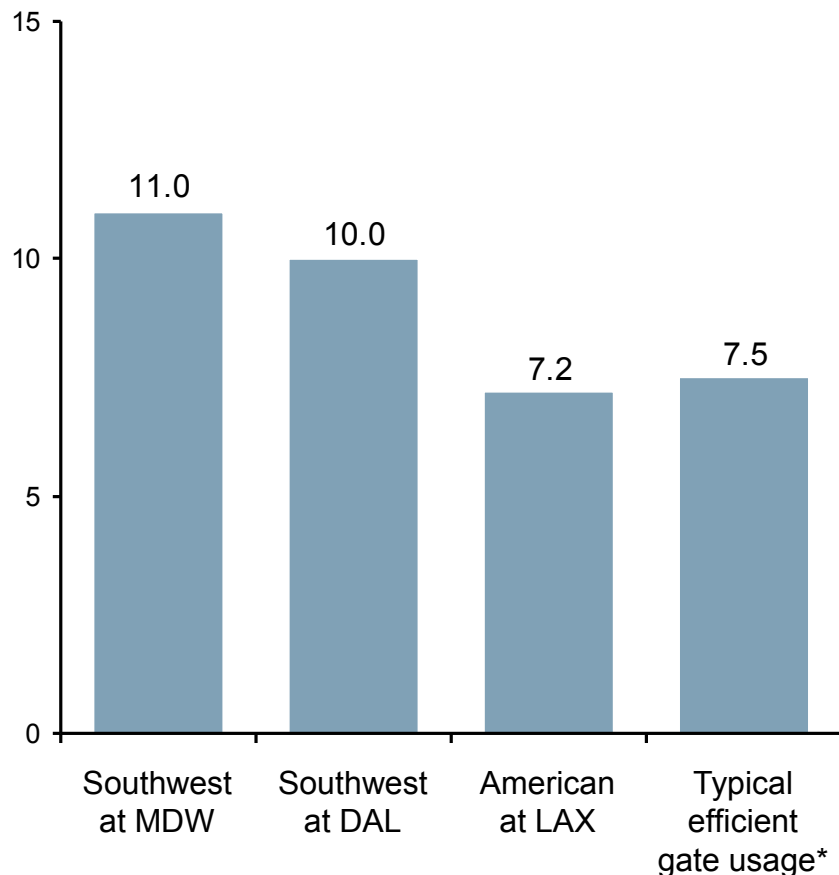
Note: * Calculated as (aircraft seats) x (flights/day) x (system-wide load factor); ** Max potential assumed to be 11 turns per day based on Southwest performance at MDW; typical efficient gate usage is 7-8 turns per day; *** 2012 system wide load factor; ^ Some flights may be operated by an E175 with the same number of seats; ^^ Based on the assumption that Delta only gets two gates (proposing 16 total for 3 gates)

Source: L.E.K. analysis of ADP; company proposals; company seating charts

② The Southwest and Delta proposals likely represent the maximum daily usage of the available gates

Maximum efficient gate usage

Number of gate turns per day



Note: * Based on L.E.K. experience and industry observation
Source: L.E.K. analysis of Diio Mi

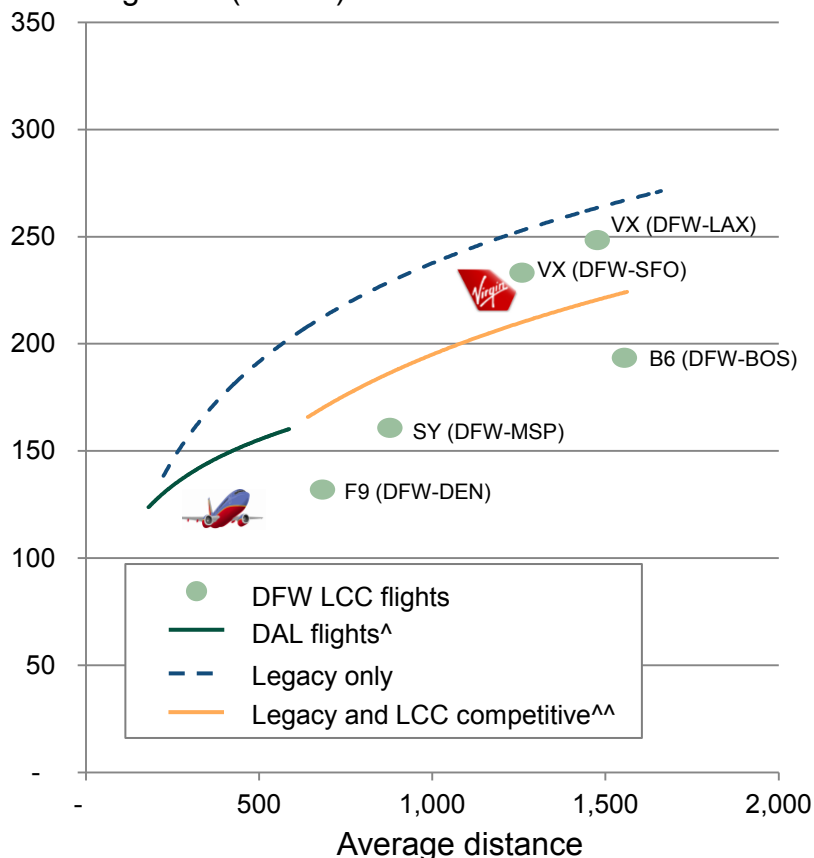
- Maximum efficient gate usage is based on three main factors:
 - (1) Size of aircraft, as larger aircraft take longer to turn
 - (2) Airline operational efficiency, as certain airlines perform better at catering, fueling, inspecting, and loading aircraft
 - (3) Consistency of demand throughout the day, as airlines attempt to match their schedule to the most popular times to fly (typically motivated by business travel)
- In gate-constrained situations, U.S. airlines typically can operate ~7.5 flights per day out of a single gate
 - At LAX, where pre-merger American is gate-constrained, it is able to support ~94 mainline flights per day out of its 13 gates (7.2 flights per gate per day)
 - Southwest, with an all narrow-body fleet and efficient operations, is able to support up to 11 flights per day at some gates at MDW

Given industry evidence of efficient gate usage, we have assumed that 10-11 turns per gate is a reasonable estimate for DAL

3 Historically, Southwest has driven a greater fare differential in Dallas than Virgin; however it has a mixed track record in other markets

Average domestic fares from DAL and DFW (Q3 2012-Q3 2013)

Average fare (dollars)



Fare differentials from legacy fares in similar markets to DAL/DFW

(Q3 2012-Q3 2013)

Comparison	Houston (HOU/IAH)	Chicago (MDW/ORD)
Avg. WN fare differential (%)	20	13
Avg. LCC fare differential (%)	28	28

Key Observations

- Historically, Virgin has not offered significantly lower fares in Dallas relative to WN or other LCCs
- Neither Southwest nor Virgin typically offer Dallas fares as low as JetBlue, Frontier, or Sun Country
- While Southwest has historically offered lower fares in Dallas, Houston, and Chicago, its track-record is mixed – fares have actually increased ~23% in ATL (vs. 4% nationally) since Southwest took over AirTran

Note: * Only nonstop destinations from DAL with passengers per day greater than 50 passengers per day; NK was not included in this analysis, as they appear to have minimal impact on other carrier's fares; ^ "DAL flights" are all non-stop flights from DAL; ^^ "Legacy and LCC competitive" are routes with both Legacy and LCC presence

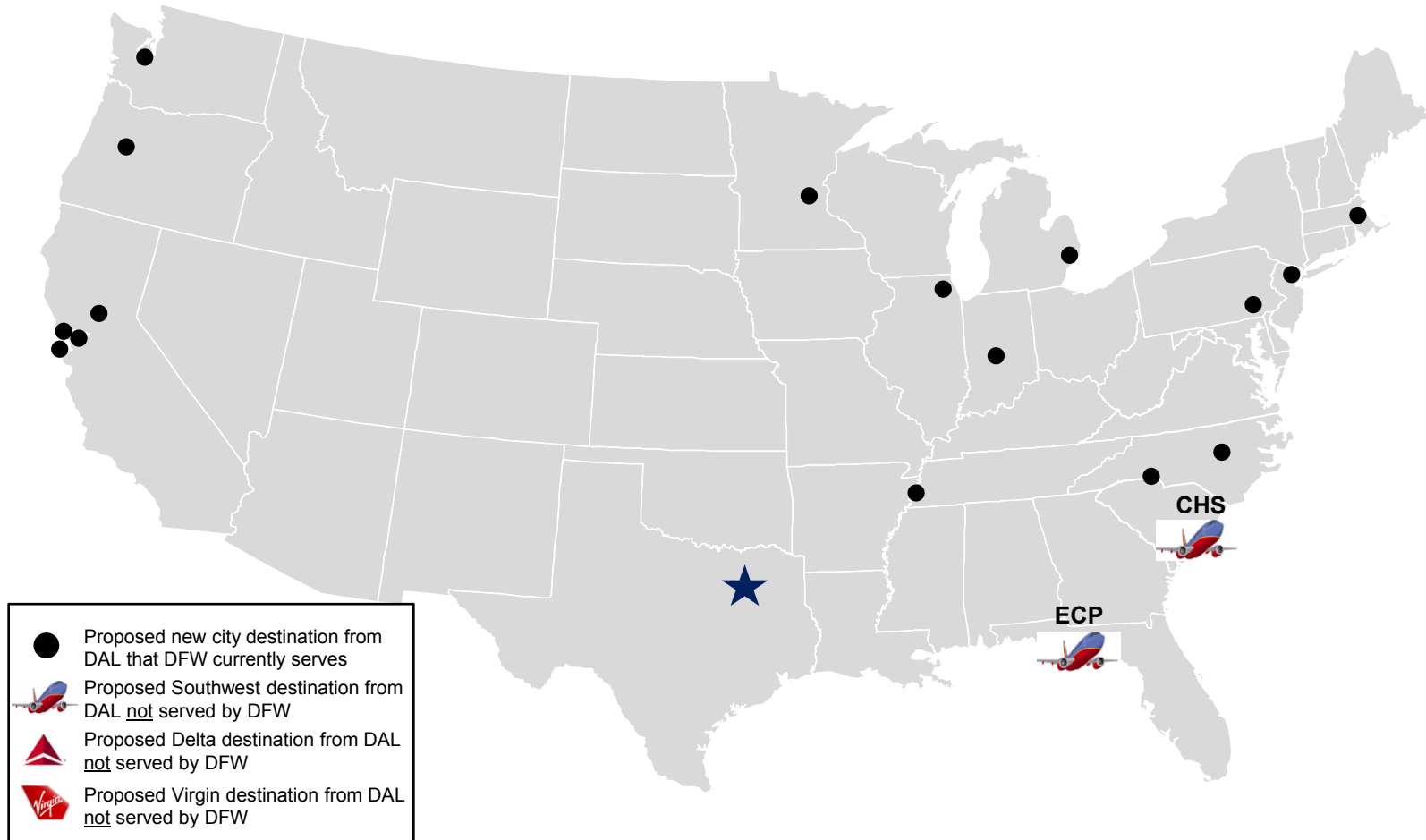
Source: Airlines and Aviation: Dallas Business Telegram, L.E.K. analysis of Dio Mii

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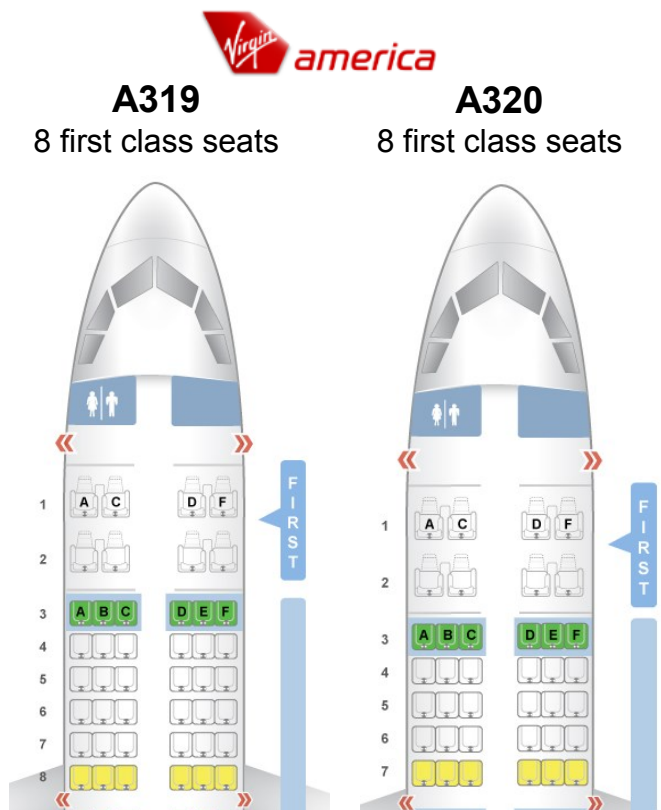
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4 Despite the substantial increase in nonstop destinations, only CHS and ECP (both Southwest) do not overlap with existing service from DFW

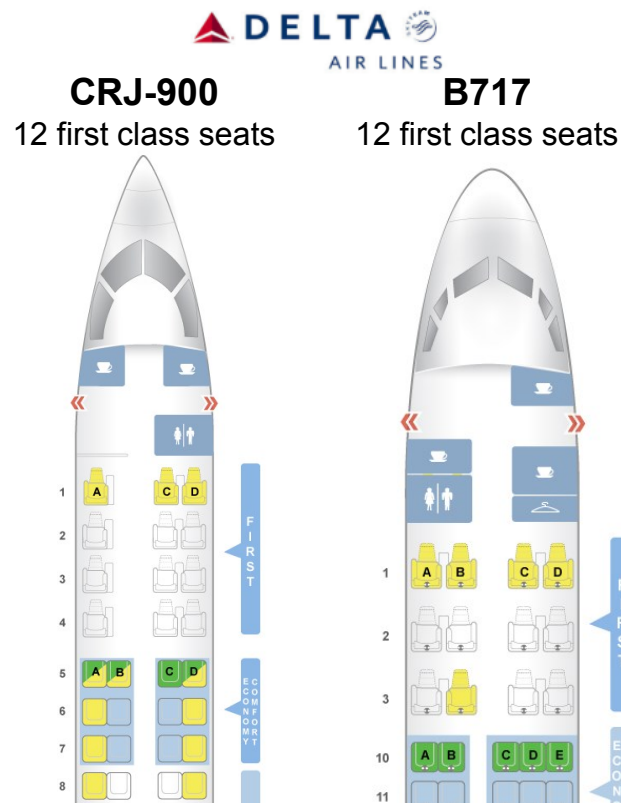
Incremental non-stop destinations from DAL by carrier



- 5 With both more flights and more first class seats per aircraft, Delta would provide the greatest increase in premium class service at DAL



8 first class seats x 18 flights
= 144 first class seats per day



12 first class seats x 20 flights
= 240 first class seats per day

Delta or Virgin would likely create the greatest number of new jobs at DAL and similarly represent a greater opportunity to increase corporate partnership with the community (whereas Southwest is already a strong partner)

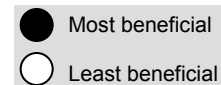
6 Increase number of DAL jobs	<u>Rationale</u> <ul style="list-style-type: none">Additional carriers at DAL would likely require incremental airport employees	<u>Implications</u> <ul style="list-style-type: none">Virgin or Delta would likely create more jobs at DAL due to the added requirements of supporting an incremental carrier
7 Airline stability and commitment	<ul style="list-style-type: none">Given that DAL currently relies on Southwest for 96% of all passenger throughput, it is significantly exposed to any risk associated with the airlineDiversification could mitigate some of DAL's airline customer risk	<ul style="list-style-type: none">Delta is the only legacy carrier vying for the gates at DAL and given its scale is likely the most stable of the three carriers; however, DL has left Dallas once before
8 Add a partner that will contribute to the community	<ul style="list-style-type: none">American Airlines and Southwest both have a large footprint and positive impact in the Dallas communityIf a carrier receives preferential gates at restricted DAL, a similar high level of community involvement should be expected	<ul style="list-style-type: none">Southwest, one of the largest employers in Dallas, is very likely to remain at DAL; we expect that they will use the gates fully but may not reach new destinations as those markets are unprovenWhile Virgin would help from a diversification standpoint, it would come with some element of risk, as it is the smallest of the three carriers with the smallest existing presence in Dallas
	<ul style="list-style-type: none">If either Delta or Virgin could use the gates at DAL to grow their presence in the market, they could similarly increase their profile in the community and partnership with the cityIt is less likely that the gain of 2 incremental gates would have a material impact on Southwest's community support, which is already strong	

Southwest is the most attractive option for the City of Dallas, given both expectations for its O&D pax throughput and potential for low fares

Objectives (% weighting)



Rationale



Tier 1 (50%)	1	Increase non-stop destinations from DAL				<ul style="list-style-type: none"> Southwest is proposing 17 new nonstop destinations vs. 5 (DL) and 5 (VX)
	2	Maximize O&D pax throughput across DAL & DFW				<ul style="list-style-type: none"> While both Southwest and Virgin would serve substantial passengers, Virgin would be removing flights from DFW
Tier 2 (40%)	3	Lower fares from DAL				<ul style="list-style-type: none"> Historically, Southwest has driven a greater fare differential in Dallas than Virgin; however it has a mixed track record in other markets
	4	Minimize route overlap with DFW				<ul style="list-style-type: none"> ECP and CHS (both WN) are the only proposed new destinations that are not currently served by DFW
	5	Add convenient premium class service at DAL				<ul style="list-style-type: none"> With both more flights and more first class seats per aircraft, Delta would provide the greatest increase in premium class service at DAL
Tier 3 (10%)	6	Increase number of DAL jobs				<ul style="list-style-type: none"> VX or DL would likely create more jobs at DAL due to the added requirements of supporting an incremental carrier
	7	Airline stability and commitment				<ul style="list-style-type: none"> Delta's scale gives it stability although it has left Dallas before, while Southwest is fully committed as the home-town carrier
	8	Add a partner that will contribute to the community				<ul style="list-style-type: none"> DL or VX represent a greater opportunity to increase corporate partnership with the community (whereas Southwest is already a strong partner)

Overall attractiveness



Southwest is the most attractive option for the City of Dallas

A common-use strategy could allow the City to manage the gates in an optimal way across carriers

Benefits of a common-use model

- Airlines could be held accountable for the benefits stated in their proposal (planned routes, aircraft) if they risk losing the gates
 - Conditions can be made public that gate usage is lost when destinations or routes fall below a predetermined number and a competing carrier desires to add service
- Common use is generally seen as the best way to allow new entrants
 - “... Airport-controlled common-use gates give the airport operator more flexibility to assign gates and to facilitate entry ...”
FAA/OST Task Force, October 1999
- Depending on carrier flexibility, more than one of the bidders could be partially accommodated within the two gates
- Additional carriers that may not be able to support a full gate at DAL would have easier access to the terminal on a more limited basis, for example:
 - JetBlue could shift its three BOS flights from DFW to DAL
 - Allegiant could have a Saturday flight to LAS

Agenda

- Background and objectives
- Review of airline proposals and recommendations
- Appendix

Current DFW and DAL nonstop destinations in the U.S. with more than 50 passengers per day

Airport Code	PAX per day	Airport Code	PAX per day	Airport Code	PAX per day	Airport Code	PAX per day
ORD	1310	DCA	472	MDW	172	RIC	90
LAX	1238	SAN	471	BHM	170	VPS	86
DEN	1215	FLL	462	OMA	161	BTR	83
ATL	1156	SNA	406	CLE	156	HNL	80
LAS	1082	TPA	386	MKE	148	RNO	72
LGA	1061	ELP	353	JAX	147	DSM	72
HOU	1060	ABQ	335	SMF	144	JAN	71
SFO	834	CLT	333	OKC	132	SJU	70
STL	804	BNA	315	ONT	130	XNA	66
SAT	753	TUL	286	CRP	120	ICT	63
MCO	750	SLC	282	HRL	118	TYS	59
BOS	741	LBB	282	BDL	117	PNS	57
PHX	623	MAF	267	SDF	113	ORF	57
PHL	622	MIA	260	RSW	113	GSP	54
MSY	607	IAD	257	COS	105	GRR	53
MCI	547	LIT	247	TUS	103		
MSP	546	AMA	239	MEM	103		
SEA	532	PDX	222	MFE	100		
EWR	529	IND	207	CVG	99		
AUS	520	SJC	203	AZA	98		
DTW	500	CMH	193	OAK	96		
IAH	494	PIT	192	PBI	92		
BWI	487	RDU	174	DAY	91		